

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Claim for Refund of JACK DONALD Claimant

Appearances:

For Claimant: Mr. Spencer T. Malysiak
Attorney at Law

*For Business Taxes Appeals
Section, Legal Division:* Ms. Susan M. Wengel
Assistant Chief Counsel

MEMORANDUM OPINION

This opinion considers the merits of the claim for refund under the Sales and Use Tax Law for Jack Donald Freels as follows:

1. Liability for tax on sales by a suspended corporation for the period August 15, 1990 through June 15, 1992, in the amount of \$34,152.94;
2. Claimant's bank account was levied upon for \$65,194.89, which is the subject of claimant's refund.

This claim was originally heard by the Board on May 3, 1995, at which time the Board ordered the claim to be held in abeyance pending the Sales and Use Tax Department's investigating the liability of Mr. and Mrs. Christiansen, who Mr. Freels claims are the true owners. On April 10, 1997, on an Adjudicatory Calendar, the matter was returned to the Board. At that time the Board directed the Appeals Section to prepare a Memorandum Opinion.

Claimant is the President and owner of Capital Video Incorporated, a corporation which rented video tape films. The corporation did not hold a seller's permit.

The corporation began operations on July 1, 1984. On August 15, 1990, the corporate charter was suspended by the Secretary of State. The business continued to operate until June 15, 1992. Sales tax reimbursement was collected but not remitted to the Board.

The Sales and Use Tax Department audited claimant and the corporation but no records were provided. To establish gross receipts for the corporation for the period from July 1, 1984 through June 30, 1989, the auditor used Federal Income Tax Returns. Because no records were provided for the later periods, average quarterly gross receipts for the period July 1, 1988 through June 30, 1989, were used to estimate taxable sales made in those periods.

A Notice of Determination was mailed to the corporate address obtained from the Office of the Secretary of State as neither the corporation nor claimant held a seller's permit or provided the Department with an address. No response was received and the determination became final.

In addition to the determination issued to the corporation, dual determinations were issued to claimant. The determination for the period July 1, 1984 through August 14, 1990 was based on corporate officer liability pursuant to Revenue and Taxation Code section 6829. The Department concluded that because claimant was the owner and president of a corporation that had been terminated, and because tax was collected from customers, he should be liable for the tax, interest, and penalties due from the corporation for the period in which the business was operated by the corporation.

The second determination was for the period from August 15, 1990 through June 15, 1992 and was based on unreported sales by claimant. The Department found that because a corporation is an artificial person which exists only by reason of being chartered by the State, once a charter is suspended, the corporation cannot operate. In other words, if the business of the corporation continues, it must be operated by individuals. This determination, against claimant as an individual, included tax, interest and penalties for failing to file returns and for knowingly operating without a seller's permit.

Claimant's bank account was levied upon for \$65,194.89, which is the subject of claimant's claim for refund.

This matter was heard by the Board on May 3, 1995. Claimant contended that the claim should be granted but the Board ordered the claim to be held in abeyance pending the Department locating and determining that a billing to Mr. and Mrs. Christiansen, who, claimant alleged, were the owners and operators of the business during the period August 15, 1990 through June 15, 1992, was appropriate. Action on the claim for refund was not to be taken until after the Christiansen matter was resolved.

The Department investigated the Christiansens but did not request a determination because the Department found that the Christiansens did not have any attachable assets or income. The liability had been paid in full by claimant so there was no liability to bill unless claimant received a refund. Additionally, the Department has a policy of issuing a dual determination only if attachable assets or income can be located.

On June 30, 1980, the Board adopted a policy of asserting tax against corporate officers of closely held corporations when sales tax reimbursement has been collected from customers and the corporation's powers, rights, and privileges have been suspended by the Franchise Tax Board for failure to pay the franchise tax. The Sales and Use Tax Department had construed this to include all suspended corporations.

On November 15, 1995, the Board, in deciding an unrelated petition for redetermination, ordered that this particular petition be granted because the corporate suspension was not for failure to pay taxes to the Franchise Tax Board. In relying on this direction from the Board, the Appeals Section requested that the Department contact the Franchise Tax Board and ascertain if the corporate suspension for claimant's corporation was based on Capital Video, Incorporated's failure to pay taxes to the Franchise Tax Board. The Appeals Section, once they were advised that the suspension was not for failing to pay the Franchise Tax Board, narrowly construed the

Board's 1980 policy and recommended that as to the liability incurred by claimant from August 15, 1990 through June 15, 1992, the claim should be granted.

The issue presented in this Memorandum Opinion is whether the claim for refund should be granted because the corporation was not suspended for failing to pay its taxes to the Franchise Tax Board. We conclude that it should not.

There is both a statutory basis and a basis in California case law upon which to assert personal liability for tax assessments against the officers-shareholders of a closely held corporation which has been suspended by the Secretary of State but continues to conduct selling activities and collects sales tax reimbursement from customers. In *Decorative Carpets, Inc. v. State Board of Equalization* (1962) 58 Cal.2d 252, the California Supreme Court concluded that excessive sales tax reimbursement collected by a retailer gave rise to an involuntary trust with the retailer acting as the involuntary trustee of the funds. When these funds were paid to the Board of Equalization, the Board could insist on the retailer refunding the excess tax reimbursement to the customers as a condition to the Board's refunding of the overpayments to the retailer. The court noted that the Board "has a vital interest in the integrity of the sales tax . . .", and that "[t]o allow (the retailer) a refund without requiring it to repay its customers the amounts erroneously collected from them would sanction a misuse of the sales tax by a retailer for his private gain." (at page 255) Therefore, officers-shareholders of a closely held corporation who continue to operate a business which has had its corporate powers suspended and continue to collect sales tax reimbursement from the customers of that business are involuntary trustees of those funds. For the Board to permit the corporate officers-shareholders to retain those funds sanctions a misuse of the sales tax by them for their private gain and undermines the integrity of the sales tax. These funds are collected as sales tax reimbursement from customers and are a debt owed by the business to the State of California.

Under the statutory provisions of the Sales and Use Tax Law there is further authority to hold officers-shareholders of a suspended corporation liable for the sales tax which the business owes the State and has already collected from customers as sales tax reimbursement. The officers of a corporation are the persons who conduct the business of the corporation, and if the Board were to pursue someone other than the corporation for liabilities generated during the period of suspension the persons to pursue are the persons who conduct the business.

Revenue and Taxation Code section 25962.1 makes it a crime for any person to purport to exercise the powers of a corporation which has been suspended pursuant to Revenue and Taxation Code section 23301. When corporate officers-shareholders conduct selling activities during a period in which the corporate powers are suspended they are not exercising the corporate powers but are acting as individuals. Revenue and Taxation Code sections 6014, 6015, and 6066 indicate that the officers-shareholders as individuals are sellers within this state and must hold a seller's permit. As the Sales and Use Tax Law, by its own terms, applies to claimant's actions of engaging in selling activities during the period of suspension of the corporation's powers, it is appropriate to treat claimant as one engaged in an activity requiring the holding of a seller's permit. The reason for the corporate suspension will not affect this conclusion. It is the fact that the corporation is suspended and yet the officers-shareholders as

individuals continue the selling activities that triggers the officers-shareholders' responsibility as sellers to obtain a seller's permit and to report and remit sales tax to the State.

OPINION

We conclude that the claim for refund be denied. To the effect that any Board publications, policies, or annotations are inconsistent with this Memorandum Opinion, we further conclude that this Memorandum Opinion will have precedence.

Done at Sacramento, California, this 10th day of September, 1997, by the State Board of Equalization.

Ernest J. Dronenburg, Jr., Chairman
Johan Klehs, Member
Dean F. Andal, Member
Rex Halverson*, Member
John Chiang**, Member

* For Kathleen Connell, per Government Code section 7.9.

** Acting Member, 4th District